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SUBJECT: ATLANTIC CANADA ECONOMIC OUTLOOK: MODERATE GROWTH FOR 2005

[1](#)1. SUMMARY: Atlantic Provinces Economic Council's annual business outlook briefing predicts moderating growth for Canada's four eastern provinces. Softening global demand and prices for commodities and forest products, low or no growth in tourism, a cooling housing market and declines in consumer spending all add up to regional growth in 2005 that will be about one percentage point below the forecast for Canada as a whole. Major project spending -- non-residential construction and offshore energy investment -- remains a positive factor in the near term, but a "project gap" is looming in 2006-2007 that could undermine growth unless offset by other stimulus. Competition from Asia is growing for traditional regional exports such as seafood. END SUMMARY.

[1](#)2. David Chaundy, Senior Economist for the private think tank Atlantic Provinces Economic Council (APEC) briefed CG and other attendees of the Council's annual economic outlook conference for the region November 15. Chaundy's estimate for overall Canadian economic growth in 2004 is 2.9%, and his estimate for 2005 is 3.1%. For Atlantic Canada the picture is not quite as good. The APEC forecast notes a number of key negative factors that are likely to have an impact on regional growth:

-- slowing demand and softening prices in 2005 for commodities produced in and exported from the region, including iron ore, wood products, pulp, and rubber products;

-- a soft tourism market in 2004 may indicate that the boom years for tourism are over and that there will be fewer new opportunities for growth in this sector. One bright spot for tourism is cruise ship arrivals, which continue to climb from their 2002 slump;

-- declines in housing starts to 1991-94 levels;

-- a significant drop in consumer spending including for new cars;

-- declining job growth after summer 2004 peaks.

[1](#)3. The strength of the Canadian dollar is likely to have a significant impact on Atlantic Canadian businesses, and the APEC forecast anticipates that exports will take a hit in 2005. Businesses in the region and across the country will need to examine how to cut costs and increase productivity to compensate for the high loonie. One silver lining of the Canadian dollar's rise is that capital investment in the form of imported machinery could become relatively cheap and spark a capital spending boom such as the one in the late 1980s and early 1990s.

(NOTE: We have converted Canadian dollar figures to U.S. dollars at a rate of US\$0.82 = C\$1.00. END NOTE.)

[1](#)4. On the bright side for the region's economy, Chaundy noted that federal government investment will help ease provincial budget squeezes, with higher than anticipated equalization payments and additional transfers for health care. In the case of Nova Scotia the federal windfall will amount to about 3.6% of total provincial revenue, a roughly C\$200 (US\$164) million boost. (That is offset, however, by an approximately 7% boost in the province's health care spending.) In addition, major project spending -- such as offshore energy, mining, road building and liquefied natural gas plants -- should rise by about 12% across the region, with most of the increase in Newfoundland/Labrador and New Brunswick. Announced projects, however, run out by mid-2006, leaving a potential "project gap" until mid-2008 when Lower Churchill Falls Hydro construction and the Deep Panuke offshore project potentially kick in.

NOVA SCOTIA

[1](#)5. Atlantic Canada's largest economy, according to the APEC forecast, will grow by approximately 2.2% this year and 2.5% in [1](#)2005. Increases in services and manufacturing are and will continue to offset declines in offshore energy production. The unemployment rate will continue its gradual decline, from about 12% ten years ago to under 9% in 2005. Strong employment growth in business services in recent years has helped both cut unemployment and raise the participation rate in the economy. Major project spending for 2005 will be a mix of public and private initiatives including an LNG plant in Cape Breton,

cleanup of the Halifax harbor and the notoriously polluted Sydney Tar Ponds, the Sable Island natural gas compression platform and a major expansion of the community college system's infrastructure.

16. Nova Scotia's main export market by far is the U.S., with 2004 exports to date -- C\$3.2 (US\$2.6) billion -- running about 4% ahead of last year. Primary exports to the U.S. are natural gas (21%), fish (21%) and tires (13%). Offshore energy exploration has fallen sharply since 2003 and production is projected to level off at around 4.5 billion cubic meters in 2004 and 2005. APEC's Chaundy noted that something is needed to rekindle interest in Nova Scotia's offshore energy resources if the sector is to play a major role in stimulating growth.

NEW BRUNSWICK

17. After solid growth of 4% in 2003, New Brunswick is likely to see about 2% growth in 2004 and about 2.7% in 2005. Unemployment will tend downward to just above 10%. Major investment in 2005 will include an LNG plant outside of St. John, a federal/provincial highway project, new electric power infrastructure to better link NB Power to the Maine grid and permit more efficient energy imports and exports, and a new Molson brewery in Moncton. New Brunswick's primary export to the U.S. -- 42% of the total -- is refined oil, making it by far the largest Atlantic exporter to the U.S. with C\$5.7 (US\$4.7) billion so far in 2004. Overall exports to the U.S. are up by 11% so far in 2004. Paper and wood products account for about 10% each of the province's remaining exports.

NEWFOUNDLAND AND LABRADOR

18. Economic growth in Newfoundland and Labrador was 6.5% in 2003, driven primarily by oil production and investment in offshore energy, the APEC forecast sees Newfoundland/Labrador growth falling dramatically to 1.7% for 2004 and 1.2% in 2005. Unemployment will remain in the 16% range, with new jobs created in manufacturing, trade and construction but lost in the public service and health care. The province's exports -- over half of which are refined and crude oil -- will be up slightly in 2004. The U.S. remains by far Newfoundland's largest export market -- over C\$2.1 (US\$1.7) billion so far in 2004 -- although exports to China -- mainly fresh and frozen seafood for processing -- are up so far this year by more than 29% to C\$239 (US\$196) million. Business investment has played a major part in the NL economy in recent years, but it will slow in 2005 as initial spending begins on the White Rose offshore energy project, the Voisey's Bay, Labrador, nickel mine and mill and the St. John's harbor clean-up project. White Rose should boost oil production -- and provincial economic growth -- significantly by 2006.

PRINCE EDWARD ISLAND

19. Tiny PEI, according to the APEC forecast, will move from less than 2% growth in 2004 to around 2.3% in 2005. Low potato prices, which brought down farm receipts significantly in 2004, are a main factor in the Island's current sluggish growth. Processed potatoes make up over 30% of PEI's exports, with raw potatoes another 7% and fish and fish products more than 20%. Unemployment will remain in the 11% to 11.5% range. Exports to the U.S. have fallen slightly so far in 2004 to C\$362 (US\$297) million. No other country comes close to the U.S. as an export market for PEI, although fish exports to Japan are up this year by about 200% to C\$11.2 (US\$9.1) million.

COMMENT

10. Overall the APEC forecast predicts that Atlantic Canada will trail the rest of the country in economic growth in 2004 and 2005. Offshore energy, which has been a major factor in growth for the region, is stalled for the moment, despite high prices which should normally trigger investment in the sector. Waning interest in the offshore, particularly Nova Scotia's after several disappointing exploratory wells, will take time to reverse.

11. APEC's President, Elizabeth Beale, told the conference that Atlantic Canadians need to take stock of how their economies are structured. Dependence on exports of primary products -- mainly to the U.S. but increasingly to Asia -- means that "we have a developed economy but Third World export patterns." The goal of value-added processing at home remains as elusive as always, and structural factors such as labor costs and rigidities mean that Atlantic Canada will likely see an increasing flow of its products, such as iron ore and seafood, going to developing countries to be turned into finished products and sold either back to Canada or to the region's traditional export market, the United States. Beale's analysis of Atlantic Canadian exports facing direct or indirect competition from Asia should be cause for serious thought among businesspeople in the region.

